Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Zettel | Analyst: Darrine Distefano | Bill Number: AB 2561

Related Bills: See Legislative History | Telephone: 845-6458 | Introduced Date: 02-24-2000

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Exclusion/Retired Pay and Survivor Annuities Received from Retirement from Armed Forces

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would exclude from California gross income any military retired pay and any survivor annuities received as a result of active service as a member of the armed forces of the United States.

EFFECTIVE DATE

As a tax levy, this bill would be effective immediately upon signature and would apply to taxable years beginning on or after January 1, 2000.

LEGISLATIVE/PROGRAM HISTORY

Prior law (Ch. 147, Stats. 1943) allowed a deduction from gross income for all salaries, wages, bonuses, allowances, and other compensation received for service as a member of the Armed Forces for taxable years 1943 through 1948 (World War II). Ch. 12, Stats. 1952, reinstated the World War II exclusion but limited it to $1,000 per year. In 1971, Ch. 1, Stats. 1971, Ex. Sess., further limited the exclusion to compensation (other than pensions and retirement pay) received for service on extended active duty. For taxable years commencing after December 31, 1972, Ch. 1359, Stats. 1972, added an annual $1,000 exclusion from gross income for pensions and retirement pay as well as for compensation for other than extended active duty. This exclusion, however, was limited to taxpayers with adjusted gross income of $17,000 or less. AB 66 (Ch. 1461, Stats. 1985) increased the phase-out range to $27,000, for taxable years beginning on or after January 1, 1985. AB 4419 (Ch. 779, Stats. 1986) excluded from gross income up to $500 per month received for active duty service pursuant to a Governor-declared emergency. AB 53 (Ch. 1138, Stats. 1987) repealed each of these exclusions and established a tax credit, not to exceed $40 in any taxable year, based on various types of military income. The credit was repealed by its own terms effective January 1, 1992. AB 1365 (99/00), which failed passage in the Assembly Revenue and Taxation Committee, would have excluded from gross income any military retirement pay, military disability pay or any other benefits received by a person retired from the armed forces. SB 1725 (99/00), as introduced February 24, 2000, is identical to this bill and would exclude from California gross income any military retired pay and any survivor annuities received as a result of active service as a member of the armed forces of the United States.

Board Position:			Department Director	Date
____ S	____ NA	____ NP	Alan Hunter for GHG	3/16/00
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SPECIFIC FINDINGS

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation, business income, gains from property, dividends, rents, interest and royalties, unless such income is specifically excluded or exempt.

Existing federal and state laws provide that certain types of income are excluded from gross income, such as certain death benefits, gifts and inheritances, compensation for injuries and sickness, qualified scholarships, educational assistance programs and foster care payments.

Under federal and state laws, compensation received by a member of the Armed Forces is subject to income tax unless specifically excluded. Qualified military benefits are excludable from income. Qualified benefits include benefits paid by the Veterans Administration, such as disability compensation, pensions, educational assistance, etc. In addition, medical benefits, military disability benefits, various travel allowances and other benefits provided by the military may be excludable. Dislocation allowances, temporary lodging allowances and move-in housing allowances provided for a permanent change of station also are excludable from gross income. Compensation received for any month while serving in a combat zone is excludable.

Under current state and federal laws, a member of the armed forces of any country and the uniformed services of the United States may exclude from gross income amounts received as a pension, annuity or similar allowance for personal injury or sickness resulting from active service.

Under federal and state laws, gross income of a nonresident from sources within this state does not include any retired or retainer pay of a member or former member of a uniformed service, as computed under Title 10 of the United States Code and received on or after January 1, 1996.

This bill would provide that gross income shall not include retired pay or survivor annuities received by an individual as a result of the active service of a member of the armed forces of the United States.

Policy Considerations

This bill would create differences in the calculation of income between federal and California tax law, thereby increasing the complexity of California tax return preparation.

Implementation Considerations

Implementing this bill would not significantly impact the department’s programs and operations.

FISCAL IMPACT

Departmental Costs

This bill is not expected to significantly impact the departmental costs.

Tax Revenue Estimate

Based on data and assumptions discussed below, the following revenue losses are projected to result from this proposal:

Estimated Revenue Impact of AB 2561 As Introduced February 24, 2000 Assumed Effective From 1/1/00 With Enactment After 6/30/00 (In **$Millions**)			
Fiscal Years	2000/01	2001/02	2002/03
Revenue Impact (Rounded)	-$235	-$195	-$200

Any possible changes in employment, personal income, or gross state product that might result from this provision are not taken into account.

Revenue Discussion

Revenue losses would depend on the amount of qualified retired military payments received in any given year for which state income taxes would otherwise be incurred.

According to available data from the U.S. Department of Defense, military retired pay and survivor annuities paid to California residents was nearly $299 million for the month of September 1999. The total amount for year 1999 was projected at $3,584 million. This value was increased 5% annually for a 2000 projection and for years thereafter.

This total amount was reduced 15% to allow for:

- current law exclusions for certain nontaxable disability retired pay; and
- recipients not incurring state income taxes.

A 6% average marginal tax rate was then applied to estimate the state revenue loss (on the order of $190 million for the 2000 taxable year).

The 2000/01 fiscal impact reflects all 2000 losses plus 25% of the year 2001 losses to allow for reduced estimated tax payments.

BOARD POSITION

Pending.